Spending Plans

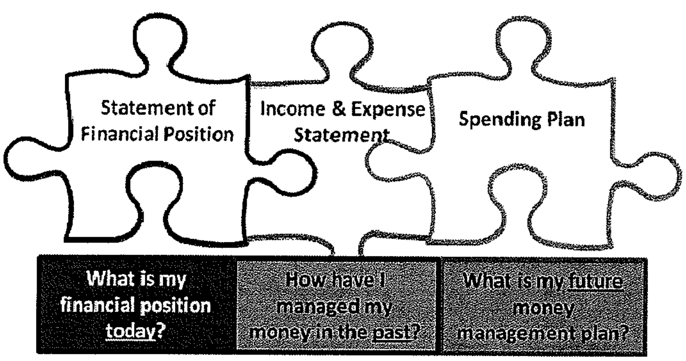
Advanced Level

The Statement of Financial Position and the Income and Expense Statement help you measure your past and present financial position. Now you are ready to make a plan for your future money management.

A **Spending Plan** is forward-looking income and expense statement sometimes referred to as a budget. It records both planned and actual income and expenses over a period of time. A Spending Plan is an important part of financial planning because it helps you take control of your spending, and, therefore, control your financial future. By using a Spending Plan to help manage your money, you will be able to increase your net worth and reach your financial goals.

Spending Plan for:		
Time Period:		
	Planned Amount	**Actual Amount**
Income		
Earned Income		
Wages or salary before deductions		
Unearned Income		
Money from savings and investments to help pay expenses during this time period		
Received Income from Government Programs		
Total Income	$	$
Expenses		
Deductions Often Taken from Paychecks		
Contributions to retirement programs (401k, 403b, pension, IRA)		
Federal income tax and state income tax		
Social Security and Medicare		
Saving and Investing (Pay Yourself First)		
Contribution to savings and investments		
Insurance Premiums		
Health, automobile, home or renters, life		
Housing Costs		
Transportation Costs		
Food Costs		
Family Member Care		
Communication and Computers		
Telephone landline, cell phone, internet, cable/satellite television		
Medical Costs Not Covered by Insurance		
Clothing and Personal Care		
Educational Expenses		
Pet Care		
Entertainment		
Gifts and Charitable Contributions		
Credit Costs		
Student loan, credit card, other loan payments		
Total Expenses	$	$
Net Gain or Net Loss (Income less Expenses)	$	$

Use the Statement of Financial Position and the Income and Expense Statement to set goals and determine what changes to make to your financial decisions. Then, use a Spending Plan to implement those changes. If you thought you spent too much on a certain expense in the past, then use your Spending Plan to limit the amount of money you plan to spend in the next time period. When comparing the Statement of Financial Position, the Income and Expense Statement and a Spending Plan, think of the differences in terms of past, present and future financial activity.



Have you ever developed a Spending Plan? If so, did it help you take control of your money? If not, do you think a spending plan would help you manage your money?

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Why is a Spending Plan an important part of financial planning?

Individuals usually have more wants than they can afford with their income. Therefore, individuals must make trade-offs in their spending decisions. A Spending Plan forces you to consider the opportunity costs of your planned purchases to help you manage your money in a way that maximizes your financial well-being.

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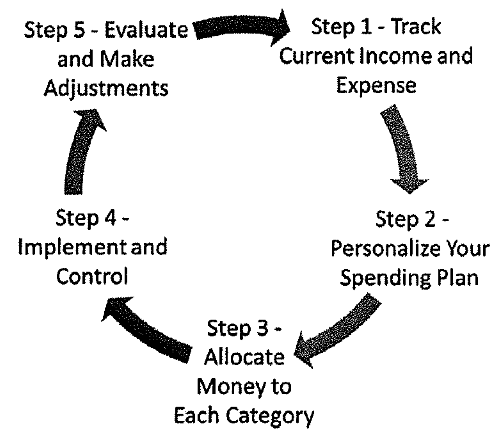
Developing Your Spending Plan

Like an Income and Expense Statement, a Spending Plan (or budget) includes income, expenses and a net gain or net loss. Creating a Spending Plan is a simple five-step process. The first three steps develop the spending plan, and the last two steps help maintain the spending plan.



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The first step to creating a spending plan is to determine how much money you earn and how you spend it. You already completed this step when you created your Income and Expense Statement, so it is important not to skip the Income and Expense Statement step. The record of your earnings and expenses on your Income and Expense Statement ensures that your Spending Plan is realistic.

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The most effective Spending Plans are those that are personalized. In this next step you should personalize your spending plan by answering three questions:

1. *How will you develop a Spending Plan?* Write down your Spending Plan because without a tangible record of your planned and actual spending, you may think that you are earning more or spending less than you actually are. You can:
    - Simply use paper and pencil to develop and keep track of your plan
    - Develop your plan in a spreadsheet for easy tracking.
    - Purchase a money management computer software program which helps develop personalized Spending Plans, as well as financial statements, tax reports and other personal finance reports.
    - Use a smartphone or tablet to download money management applications (apps).

   A spreadsheet may be created with Microsoft Excel or Google Docs. Quicken is an example of a money management computer software.

2. *Determine a time period for your Spending Plan.* A monthly time period is most common. However, you might get paid weekly or bi-weekly and prefer to set up your Spending Plan accordingly. Your Spending Plan is exactly that – **your** plan. Set a time period that meets your needs.
3. *What categories will your Spending Plan include?* Personalize your plan further by determining what income and expense categories to include. Refer to your Income and Expense Statement and determine if you need to add, change or remove any categories.

What method of creating a Spending Plan and what time period would work best for you? Why?

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Now you are ready to plan how much money to allocate in each category. Consider the following:

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- Analyze the trade-offs across spending categories to determine which allocation of your budget will make you the happiest. If the opportunity cost is too high, your planned decision may not be realistic and it may be tough to stick to the plan.
- Review your goals to ensure the Spending Plan decisions align with your goals.
- If you are considering ways to reduce your expenses, think about the expenses on your Spending Plan as contractual versus non-contractual. Contractual expenses are not easy to reduce or eliminate because you have signed some sort of contract that requires you to pay that expense for a specific amount of time (car loan, education loan, credit card debt, apartment lease). Non-contractual expenses are easier to either eliminate or reduce. Food is a necessity, but the purchase of lattes and late-night pizzas can be reduced.

Contractual	Non-contractual
Required to pay expense for a specific amount of time—not easy to reduce or eliminate	Easy to reduce or eliminate
Rent, Internet, Cell phone	Food, entertainment

Do you have any contractual expenses? If so, what are they?

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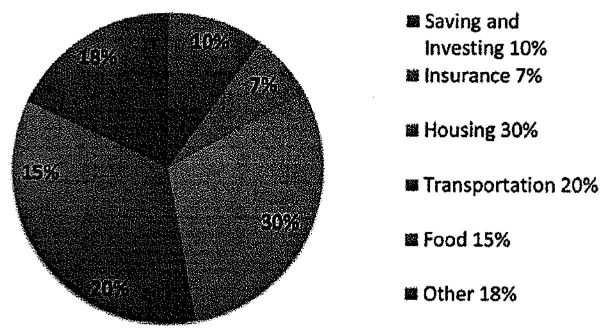
- It may help you to refer to a spending guide when deciding how much to allocate to each expense. This pie chart provides a guide for distributing net income spent to each expense category.



Once you have allocated your money, determine if you have a net gain or net loss. Subtracting expenses from income determines this. If the resulting amount is negative, it means that you have a net loss and are planning to spend more income than you have. In this case, you need to increase income, decrease expenses or do a combination of both. If the resulting amount is positive, you have a net gain. You can add more money to savings or pay down another liability. You ultimately want to have a net gain or at least a zero balance.

Income — Expenses = Net Gain or Loss

When this step is complete, you have developed a spending plan!

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4 When the opportunity to spend your income presents itself, you may find it easy to stick to your planned spending decisions. But, temptation can pull pretty hard on you, so you may find that self-control is difficult in these situations. Luckily, there are many control systems available to help you monitor your spending. Find a control system that works for you. Some examples include:

- Money management computer software: In addition to creating your spending plan, computer software programs can also function as a control system to tell you where your money is going. However, this will require you to keep track of every one of your financial transactions and enter them into the program.
- Internet-based spending plan program: There are many Internet-based spending plan programs available. Some are free and others charge a fee. The advantage of Internet-based spending plan programs is they allow you to access your information from any device that has Internet access. Also, many of these programs will link to your depository institution accounts and automatically track your spending for you. This is an advantage over most computer software programs that require you to take the time to enter your financial information. Many Internet programs have developed smartphone and tablet apps so you can access your spending plan information on the go.
- Depository institution programs: Some depository institutions offer an on-line spending plan or budgeting program that links to your account(s) and will automatically track your spending to show you where your money is going. This may be in conjunction with their online and/or mobile banking offerings.
- Check register system: The check register system is a control system that uses a checkbook register that is divided into spending plan categories. When a purchase is made, you place that expenditure into the column created for a given spending category.
- Envelope system: The envelope system is a strict control system that involves placing the budgeted amount of cash into an envelope labeled for the expense. When the envelope is empty, the budgeted amount for that expense has been spent for that time period. Be careful not to store too much cash in your envelopes because cash stored at home is more vulnerable to loss and theft. You may find that the envelope system works well for expense categories that are subject to impulse purchases. Entertainment and food purchased away from home are good examples. Using the envelope method for these categories, when the envelope is empty, further spending has to wait until the next period.

Mint and PearBudget are free Internet spending plan programs.

5 The last step is to evaluate how well your spending plan is working and make any necessary adjustments. If you find it easy to stick to your plan, then your Spending Plan works well and doesn't need adjusting. If you are having difficulty holding your spending within the allocated amounts, ask yourself if the amounts are realistic. Consider your goals when evaluating and adjusting your spending plan; this may determine if adjustments are needed.

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